THE PRINCE EDWARD ISLAND ECONOMY
PROGRESS REPORT 2006

November 2006

Economics, Statistics and Federal Fiscal Relations
P.E.I. Department of the Provincial Treasury

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INTRODUCTION

This report summarizes the progress of the Prince Edward Island economy in 2006 using available statistical information up to November 8, 2006. The report also references the national and international economic perspectives. Emerging trends in economic indicators such as labour, population, prices, consumer spending, manufacturing, construction and the primary industries are identified and discussed.

The Prince Edward Island economy continues to progress at a solid pace in 2006 and the national economic performance remains strong. For P.E.I., non-residential construction is the key economic driver in 2006, while improved retail spending, higher farm cash receipts, strong lobster landings and positive employment gains are identified as significant growth factors. Growth prospects for P.E.I. have been limited by a softer manufacturing performance and a reduction in residential construction activity. External risks affecting both national and Prince Edward Island economies in 2006 include the recent slowdown in the U.S. economy, the high value of the Canadian dollar and high energy prices.

THE GLOBAL ECONOMY

The world economy performed at a robust pace in the first half of 2006 with growth being broad-based. According to the International Monetary Fund (IMF), the global economy is projected to increase by a robust 5.1 per cent in 2006, which follows 4.9 per cent growth in 2005 and 5.3 per cent in 2004. Economic growth in advanced economies is projected to be 3.1 per cent in 2006, led by the United States and Canada respectively, while growth in emerging market and developing economies, particularly China and India, is projected to be 7.3 per cent. The IMF identified the following downside risks: inflationary concerns, large global financial imbalances, and further increases in oil prices.

THE UNITED STATES ECONOMY

The United States economy posted robust growth in the first quarter of 2006, at an annualized rate of 5.6 per cent, but softened significantly in the latter two quarters, to 2.6 per cent in the second quarter and 1.6 per cent in the third. According to the U.S. Bureau of Economic Analysis, this deceleration of real G.D.P. growth was largely attributed to a decline in housing construction. Third quarter growth in the U.S. was supported by increased consumer spending and strong non-residential fixed investment.

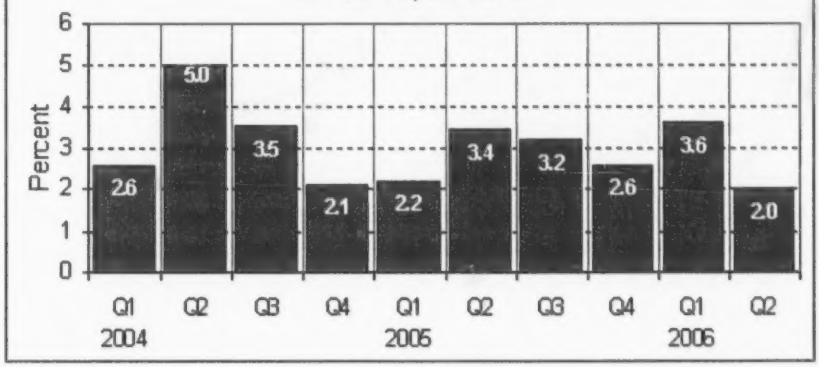
The employment situation in the U.S. continues to be favorable. From January to October 2006, employment was 1.4 per cent higher relative to the same period in 2005. This compares to annual employment growth of 1.5 per cent in 2005 and 1.1 per cent in 2004. The rate of unemployment in the U.S. in the first ten months of 2006 averaged 4.7 per cent, down from 5.1 per cent over the same period in 2005.

The U.S. Federal Open Market Committee (FOMC) continued on its path of removing monetary stimulus from the U.S. economy in the first half of 2006. From June 2004 to June 2006, the FOMC raised its target for the federal funds rate in each of its seventeen scheduled rate announcements within that period. Since June 2006, the Committee has maintained the rate at 5.25 per cent.

THE CANADIAN ECONOMY

The Canadian economy performed strongly in the first quarter of 2006, but in a similar fashion to the U.S., slowed in the second quarter. This can be observed in Diagram 1. According to Statistics Canada, the slower rate of growth in the second quarter reflected a reduced rate of growth in consumer spending and business investment, as well as a cooling in the housing market. Canadian exports declined while imports rose that quarter which further limited gains. On balance, growth of the national economy

Diagram 1
QUARTERLY REAL GDP AT ANNUALIZED RATES
2004-2006, CANADA



in the first half of 2006 was solid. In its October 2006 Monetary Policy Report, the Bank of Canada estimated that the national economy will expand by 2.8 per cent in 2006. This compares to growth of 2.9 per cent in 2005.

The employment situation in Canada continued to improve in 2006. From January to October, national employment levels increased by 1.9 per cent relative to the same period in 2005. Employment gains were concentrated in the service sector, which expanded by 2.7 per cent. Growth was largely in retail and wholesale trade, education, and finance, insurance and real estate services. Partially offsetting growth was a slight decline in goods sector employment, largely due to job losses in the manufacturing sector.

Continued strength in employment in Canada has reduced the unemployment rate in 2006. The national unemployment rate averaged 6.3 per cent from January to October 2006, down from 6.8 per cent over the same period in 2005. That year, the unemployment rate averaged 6.8 per cent.

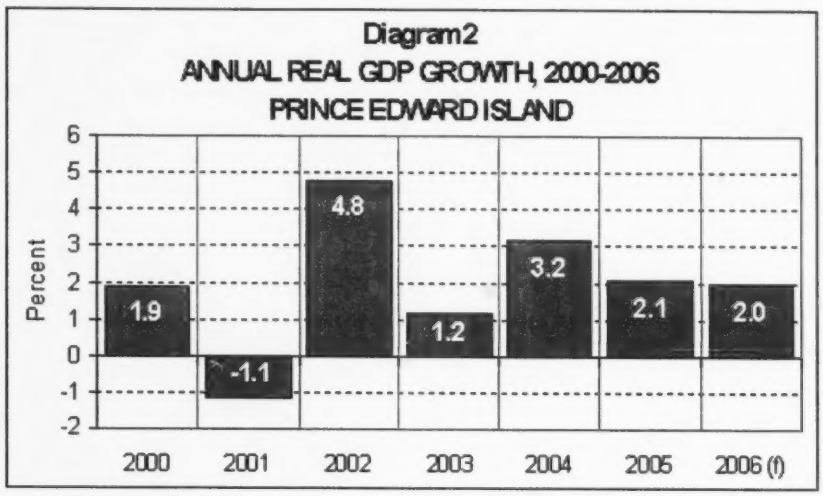
The national economic performance in 2006 was highlighted by robust economic activity in the Western provinces. The rapid pace of resource development allowed Alberta to outperform the rest of the provinces in terms of year-to-date growth in many economic indicators, primarily residential construction, manufacturing shipments, population, employment, wages and salaries and retail sales. Saskatchewan led the nation in non-residential construction investment, with P.E.I. ranked third behind Alberta. In the East, Newfoundland led the way in terms of international export growth.

Similar to the U.S. experience, the Bank of Canada continued to increase its policy interest rates throughout the first half of 2006. The Bank increased the target for the overnight rate by a cumulative 175 basis points from August 2005 to May 2006, when the rate reached 4.25 per cent, where it stands currently. In the October 2006 Monetary Policy Report, the Bank of Canada stated that "the current level of the policy rate is judged, at this time, to be consistent with achieving the inflation target over the medium term."

The Canadian dollar continued to strengthen against its U.S. counterpart in 2006. The Canada/U.S. exchange rate, as measured by the noon spot rate, averaged 88.6 cents in October which is an increase of 2.5 per cent compared to the January rate of 86.4 cents. On a year-to-date basis, from January to October 2006, the Canadian dollar appreciated against the U.S. currency by 7.7 per cent relative to the same period in 2005, on average. A high Canadian dollar makes domestic exports more expensive in international markets.

THE PRINCE EDWARD ISLAND ECONOMY

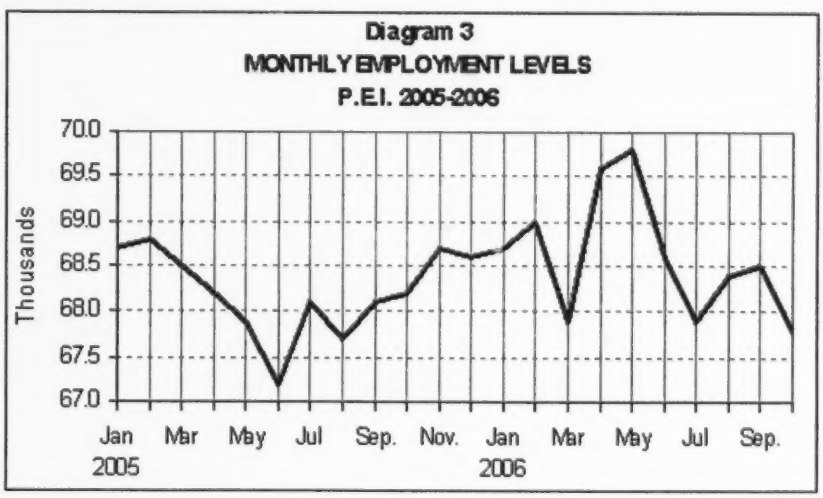
The Prince Edward Island Department of the Provincial Treasury estimates that the provincial economy will expand in the order of 2.0 per cent in 2006, at about the same pace recorded in 2005.



This is illustrated in Diagram 2 which shows real G.D.P. growth for P.E.I. on an annual basis from 2000 to the 2006 forecast. On November 8, 2006 Statistics Canada released revised G.D.P. estimates for P.E.I. which shows an improved rate of growth in 2005, of 2.1 per cent compared to the previous estimate of 1.9 per cent. Economic growth in P.E.I. was the highest among the Atlantic Provinces in 2005. In addition, Statistics Canada notes that average annual growth for P.E.I. over the 2002-2005 period, at 2.8 per cent, lies just ahead of the national average, citing the growing importance of the Island's food processing and aerospace sectors to the P.E.I. economy. The Island economy continues to progress at a solid pace in 2006 in spite of external pressures, namely the high value of the Canadian dollar and high energy prices.

THE LABOUR MARKET

Employment conditions in Prince Edward Island in 2006 continue to improve. From January to October 2006, average employment was 0.7 per cent higher relative to the same period in 2005. That year, employment rose by 1.9 per cent on an annual basis. Diagram 3 displays monthly seasonally-adjusted levels of employment from January 2005 to October 2006. As can be observed, employment levels



during this period peaked in May 2006, at 69,800 which represents an all-time high for the province. Employment growth in the first ten months of 2006 was largely in construction, agriculture, and business service sectors. These gains were somewhat offset by declines in public administration, education, and manufacturing employment. The seasonally adjusted unemployment rate for P.E.I. averaged 10.9 per cent between January and October 2006, unchanged relative to the same period in 2005. That year, the unemployment rate was 10.8 per cent, the lowest annual rate since 1980.

PERSONAL INCOME

Labour incomes in P.E.I. continued to expand in 2006 driven in part by employment growth. From January to June 2006, total labour income in the province valued $1,124.1 million, an increase of 3.0 per cent relative to the same period in 2005. Annual labour income in 2005 rose by 4.4 per cent. For 2006, income growth from January to June was driven by higher wages and salaries in the services producing sector, particularly in professional services, health care and trade. Nationally, labour incomes in the first half of 2006 were 6.0 per cent higher relative to the same period in 2005.

POPULATION

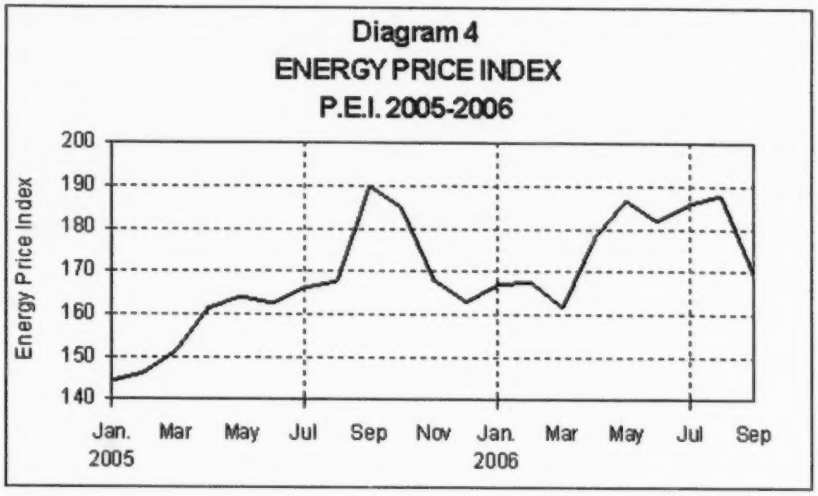
According to Statistics Canada, there were 138,519 persons living on Prince Edward Island on July 1, 2006. This was an annual increase of 343 persons, or 0.25 per cent since July 1, 2005, representing the strongest rate of growth in Atlantic Canada.

Between July 1, 2005 and June 30, 2006 the Island saw a net interprovincial outflow of 127 persons. This loss was more than offset by net international migration of 232 persons (343 immigrants minus 111 emigrants). The primary source of P.E.I.'s interprovincial in-migrants between July 1, 2005 and June 30, 2006, was Ontario followed by Nova Scotia, New Brunswick, Quebec and Alberta. These five provinces were also the main destinations of out-migrants from Prince Edward Island.

The province gained 162 people in natural increase (births minus deaths). It had 1,393 births and 1,231 deaths during this period. There were also 76 non-permanent residents living on Prince Edward Island.

CONSUMER PRICES

Inflation in P.E.I., as measured by the *All Items Consumer Price Index* (CPI), increased by 2.9 per cent during the first nine months of 2006, driven largely by higher energy prices. Diagram 4 shows the *Energy Price Index* for P.E.I. from January 2005 to September 2006. As the diagram illustrates,

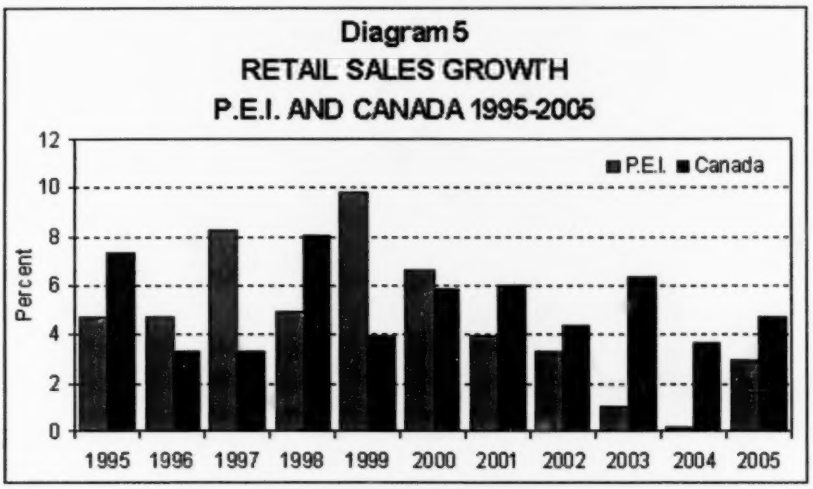


energy prices have been volatile over this period. Average energy prices in the first nine months of 2006 were 9.2 per cent higher relative to the same period in 2005. Since 2003, when concerns surrounding the U.S.-led war on Iraq started driving up world oil prices, energy prices in P.E.I. increased by a cumulative 32.6 per cent to 2005. For Canada, consumer price inflation averaged 2.2 per cent from January to September 2006, and energy price inflation over the same period was 8.1 per cent.

P.E.I. residents faced a great deal of volatility in gasoline and furnace fuel oil prices throughout the first nine months of 2006. In January, the average price of regular unleaded gasoline was 99.3 cents per litre (68.95 cents per litre for furnace fuel oil), in August pump prices rose to 119.6 (76.15) cents per litre, and in September, fell to 95.0 (68.15) cents per litre. On October 1, 2006, average prices for regular unleaded gasoline and furnace fuel oil were reduced to 90.1 cents and 64.6 cents per litre respectively.

RETAIL SALES

The Prince Edward Island economy in 2006 has benefitted from continued strength in retail spending. From January to August, seasonally-adjusted retail sales totaled $987.5 million, an increase of 3.4 per cent relative to the same period in 2005. Annual growth in 2005 was 3.2 per cent, which was a significant improvement from the previous two years as illustrated in Diagram 5. Retail sales growth in P.E.I. during the first eight months of 2006 was attributed to strong sales at gasoline stations, used car dealerships and pharmacies. Nationally, growth in the value of retail spending from January to August 2006 was 6.4 per cent higher relative to the same period in 2005.



New motor vehicle sales in P.E.I. over the January to August 2006 period totaled $91.2 million, an increase of 1.1 per cent relative to the same period in the previous year. In terms of volume, there was a 0.8 per cent increase in the number of units sold in 2006 on a year-to-date basis.

MANUFACTURING

Manufacturers on Prince Edward Island continue to adapt to exchange rate pressures. The value of manufacturing shipments in P.E.I. in the first eight months of 2006 closely matched shipments valued over the same period in 2005, as declines in non-food manufacturing were offset by stronger shipments of processed fish products. From January to August, manufacturing shipments totaled $860.9 million.

The value of food shipments in the first eight months of the year totaled $526.6 million, nearly 1.0 per cent higher relative to the same period in 2005. Though the value of food (excluding fish) shipments, largely comprised of processed potato products, declined on a year-to-date basis, shipments of processed fish products surged by 22.7 per cent, which more than offset the decline.

The value of non-food shipments was $334.4 million over the January to August 2006 period, a decrease of 2.0 per cent relative to the same period in 2005. Shipments of chemical products and fabricated metals increased in value, by 1.6 per cent and 15.2 per cent respectively, but were offset by a 4.4 per cent decline in the value of transportation equipment shipments.

INTERNATIONAL TRADE

Island exports continue to expand in 2006 and have outpaced national growth in the first eight months of the year. According to Industry Canada, P.E.I. exports of goods to international destinations valued $541.8 million from January to August 2006, an increase of $22.3 million, or 4.3 per cent relative to the same period in 2005. Nationally, exports rose by 3.6 per cent on a year-to-date basis.

Export growth in P.E.I. in the first eight months of 2006 was attributed largely to increased exports of tablestock/seed potatoes, which valued $38.5 million from January to August, an increase of $13.0 million, or 51.0 per cent relative to the same period in 2005. Frozen food manufacturing, largely comprised of french fries, increased marginally on a year-to-date basis. Partially offsetting export gains in the first eight months of 2006 were reduced export values for raw fish and wood products.

CONSTRUCTION AND HOUSING

Non-residential construction in Prince Edward Island continues to be a key driving force for the economy in 2006. According to Statistics Canada, non-residential investment from January to September valued $115.5 million, an increase of 34.1 per cent relative to the same period in 2005. This represents the third highest rate of growth in the country. In 2005, P.E.I. had the highest rate of growth in non-residential investment among the provinces, at 27.0 per cent.

Major capital construction investments in P.E.I. in 2006 include ongoing work at the new federal building in Charlottetown, Master Packaging plant expansion, the Atlantic Veterinary College expansion project, various investments through the Municipal Rural Infrastructure Fund, several condominium projects, and major wind energy initiatives.

The residential construction sector in P.E.I. continued to soften in 2006. According to Canada Mortgage and Housing Corporation (CMHC), there were 557 new housing projects started over the January to September 2006 period, which is a decrease of 13.1 per cent relative to the same period in 2005. CMHC estimates that housing starts on P.E.I. will total 750 units in 2006, which is a decrease of 13.0 per cent relative to total starts in 2005.

Though the volume of housing construction in 2006 is weaker on a year-to-date basis, new house prices continued to increase on the Island. From January to August 2006, new home prices increased by 2.4 per cent relative to the same period in 2005, falling well short of the national average of 8.9 per cent. The strength nationally is driven by a surging housing market in Alberta. New house prices in that province in the first eight months of the year have risen on average by 33.2 per cent relative to the same period in 2005.

AGRICULTURE

Improved market conditions for Island potatoes and beef helped boost farm cash receipts in 2006. Provincial farm receipts from January to June 2006 valued $207.6 million which is an increase of 11.0 per cent relative to the same period in 2005. Annual receipts that year reached an all-time high of $364.4 million. Table 1 shows annual farm cash receipts from 2002 to 2005, and year-to-date performance in 2006.

TABLE 1
FARM CASH RECEIPTS P.E.I.
($ Millions)

Year	Potatoes	Other	Total Crops	Cattle	Hogs	Dairy	Other	Total Livestock	Direct Payments	Total Receipts
2002	189.9	30.5	220.4	25.3	27.7	53.3	12.8	119.2	24.4	364.0
2003	185.3	33.7	219.0	17.7	26.5	55.0	13.4	112.7	22.8	354.5
2004	151.2	34.5	185.7	14.3	33.9	59.7	14.6	122.7	39.3	347.7
2005	161.7	32.9	194.6	20.2	27.5	61.6	14.5	123.9	45.9	364.4
2006 YTD % Change	*50.4*	*16.3*	*46.8*	*8.3*	*(25.9)*	*2.8*	*(3.2)*	*(3.5)*	*(61.3)*	*11.0*

Source: Statistics Canada

Potato market conditions for Island farmers continued to improve in 2006 reflecting higher prices. Potato receipts in the first two quarters valued $121.5 million, an increase of 50.4 per cent compared to the same period in 2005. That year, receipts were 6.9 per cent higher over 2004. Based on Statistics Canada's farm product price index for P.E.I., average potato prices between January and July 2006 were 65.2 per cent higher relative to the same period in 2005.

Based on preliminary estimates by Statistics Canada, 97,000 acres of potatoes were planted in P.E.I. in 2006. This is an increase of 1.6 per cent compared to 2005. Nationally, the area planted in potatoes declined by 1.0 per cent in 2006, due largely to planting reductions in Manitoba and Alberta.

Livestock farmers experienced gains in both cattle and dairy receipts in the first six months of 2006, but were offset by lower hog receipts. Dairy receipts valued $32.0 million from January to June 2006, an increase of 2.8 per cent relative to the same period in the previous year. Cattle receipts, at $11.9 million in the first half of 2006, were 8.3 per cent higher. Beef markets in P.E.I. continue to recover post-B.S.E. crisis. Offsetting gains in livestock receipts in the first half of 2006 was a 26 per cent decline in hog receipts. Island hog farmers have had to contend with declining prices in 2006 as demand conditions in North American markets softened.

FISHING

The lobster fishery in 2006 ended the year on a high note with lobster landings totalling 21.5 million pounds, the highest level since 1991. According to the P.E.I. Department of Agriculture, Fisheries and Aquaculture, the landed value of lobster in 2006 is estimated at $114 million.

Lobster landings in the 2006 Spring season totaled 18.9 million pounds, an increase of 17.0 per cent relative to the 2005 Spring season. That year, Spring landings fell by 10.0 per cent. Notwithstanding strong landings, market-sized lobster prices in 2006 were 4.6 per cent lower relative to average prices in the 2005 Spring season. Similarly, Fall lobster landings in 2006 also improved, to 2.6 million pounds, an increase of 11.9 per cent over 2005 landings. Fall lobster prices in 2006 were on average 1.5 per cent lower relative to prices in 2005.

TOURISM

The Prince Edward Island tourism industry in 2006 benefitted from major tourist events hosted within the Province throughout the year. These included the East Coast Music Awards, the Canadian Seniors Curling Championships, Quebec Major Junior Hockey Draft, Legends of Golf event, and the Black Eyed Peas concert.

The industry also experienced a substantial increase in the volume of air traffic in 2006. Based on key performance indicators compiled by the P.E.I. Department of Tourism, air traffic volumes from January to August 2006 increased by 24.0 per cent relative to the same period in 2005. Growth was driven by higher volumes of direct flights to Charlottetown by existing air carriers and the introduction of new carriers offering direct flight services. In other areas, total rounds played at Golf P.E.I.'s 25 member golf courses in the first eight months of 2006 were 3 per cent higher relative to the same period in 2005, and cruise ship passengers visiting P.E.I. rose in the order of 12 per cent.

The Department of Tourism notes that leisure travel across Canada fell below average levels in 2006, due to soaring gasoline prices, a high Canadian dollar, weather fluctuations and war and security concerns. For P.E.I., the volume of non-resident vehicles traveling over the Confederation Bridge from January to August 2006 declined by 2.0 per cent compared to the same period in 2005 and ferry traffic fell in the order of 4.0 per cent.

PROVINCIAL GOVERNMENT

On March 30, 2006, the Honourable Mitchell Murphy, Provincial Treasurer, presented his third Provincial Budget: *On Course. On Target.* The Budget tabled an improved fiscal position for the Province. The forecast Consolidated Deficit for 2005-06 was reduced to $18 million from the

$22 million Budget estimate, and for 2006-07, a further reduction in the consolidated deficit was budgeted, to $12.5 million.

Notable initiatives in the 2006 Budget include the multi-year plan to bring the small business tax rate from 6.5 per cent to 1.0 per cent over the next five years. Compared to 2005-06 Budget Estimates, funding for health and education increased by nearly $20 million and $11 million respectively.

The Province of Prince Edward Island Fiscal Update 2006/2007 shows a consolidated budget deficit of $12.5 million, which confirms that the Government remains on target with 2006 Budget estimates.

The improved fiscal performance of the province resulted in Moody's Bond Rating Service upgrading the Province's credit rating on long-term borrowing to an A1 rating from an A2 rating. Moody's cited a more disciplined fiscal framework as a key reason for the upgrade.

SUMMARY

Both the Prince Edward Island and national economies in 2006 are progressing at a solid pace in view of adverse economic pressures. Growth prospects for the Canadian economy is driven largely by economic prosperity in the West. On balance however, both P.E.I. and Canada face similar challenges, particularly relating to manufacturing and housing markets. Also, a weakened U.S. economic performance, a strong Canadian currency and high energy prices are concerning factors.

Prince Edward Island continues to generate strong economic advancements in 2006. Employment in P.E.I. continues to expand which keeps unemployment rates low; non-residential investment in P.E.I. continues to be robust; farm receipts in 2006 have increased over already record levels in 2005; lobster landings reached a near record high and fish processing activity in the province is strong. Improved consumer spending in 2006 continues to add momentum to economic growth in Prince Edward Island.

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